

Internal Revenue Service
memorandum

CC:TL-N-1822-90

Brl:HFRogers

date: JAN 17 1990

to: District Counsel, Cleveland CC:C
Attn: Jack E. Prestrud

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

This is in response to your request for tax litigation advice dated November 30, 1989.

ISSUES

1. Whether the petitioner is entitled to use Rev. Proc. 81-27, 1981-2 C.B. 548, to annually recompute its installment payments rather than utilizing I.R.C. § 7481(d).

2. Whether the applicable statute of limitations for substantiating the credit for state death taxes under section 2011 is section 2011(c)(1) or section 2011(c)(2).

CONCLUSION

1. The petitioner is not entitled to use Rev. Proc. 81-27 once it files its petition with the Tax Court.

2. The applicable statute of limitations is section 2011(c)(2).

DISCUSSION

The request for tax litigation advice appears to confuse the purpose and the statutory requirements of I.R.C. §§ 2011 and 7481(d). Interest which is accrued on state and federal estate taxes is deductible pursuant to section 2053. Estate of Bahr v. Commissioner, 68 T.C. 74 (1977), acq. 1978-1 C.B. 1; Rev. Rul. 78-125, 1978-1 C.B. 292. Since it is impossible to determine in advance the amount of interest which will be paid during the section 6166 installment payment period, section 7481(d) was enacted to permit the reopening of what would otherwise be a final decision. Section 2053 is under Part IV-Taxable Estate-of Chapter 11.

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Section 2011 allows a credit against the estate tax for state death taxes which are paid and credit therefor claimed within set statutory time constraints. Section 2011 is under Part II-Credits against Tax-of Chapter 11.

Interest deduction

Section 2053(a)(2) provides that administration expenses allowable under local law are deductible in determining the value of the gross estate. Treas. Reg. § 20.2053-3(a) provides that the amounts deductible from a decedent's gross estate as administration expenses are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate. While estimated items may be entered on the estate tax return, no deduction may be taken upon the basis of a vague or uncertain estimate. Treas. Reg. § 20.2053-1(b)(3).

Relying on Bahr, taxpayers began deducting interest on their estate tax returns which had not yet accrued but which the estate estimated it would pay during the pendency of the installment period. In Estate of Bailly v. Commissioner, 81 T.C. 246, reconsidered, 81 T.C. 949 (1983), the Service was successful in arguing that no deduction was allowable for an estimated interest deduction because the expense cannot be estimated with reasonable certainty as required by Treas. Reg. § 20.2053-1(b)(3). Rev. Rul. 80-250, 1980-2 C.B. 278, pointed out that the possibility of accelerated payment rendered any estimate vague and uncertain. Another factor rendering the estimate vague and uncertain was the fluctuation in interest rates. Interest rates under sections 6621 and 6601(j) are subject to change. Therefore, because installment payments may be accelerated at the option of the estate or at the option of the Service if there is a default or disposition, and because rates may fluctuate, there is a very real possibility that future interest will neither accrue nor be paid. Accordingly, the court agreed with the Service that the estate is not entitled to an estate tax deduction on its estate tax return.¹ Estate of Bailly, 81 T.C. at 252. As a result of the petitioner's motion for reconsideration, the court clarified some troubling language in its initial opinion. 81 T.C. 949. In its initial opinion, the court implied that, [REDACTED]

Rev. Proc. 81-27 describes the procedure to be followed by an estate when installment payments due under section 6166 are

¹ The interest expense may, of course, be deducted from the estate's gross income on Form 1041 pursuant to section 163, subject to the restrictions of section 642(g).

recomputed because of a reduction in the total estate tax liability due to the accrual of interest. Citing Rev. Rul. 80-250, Rev. Proc. 81-27 provides that because interest is deductible only when accrued, the estate tax may be recomputed after additional interest has been incurred.

We disagreed with the Tax Court's view in its initial opinion that the Bailly estate would be able to utilize the Rev. Proc. 81-27 procedures. For the same reasons, we disagree with the analysis of section 6512 which is set forth in your request for tax litigation advice. In the Tax Court context, the principle of finality of judgments, as expressed in the doctrine of *res judicata*, would preclude the use of the Rev. Proc. 81-27 procedure to alter a final judgment entered by the Tax Court. Tait v. Western Maryland Railway Co., 289 U.S. 620 (1935); Commissioner v. Sunnen, 333 U.S. 591 (1948). As the legislative history of section 6215 indicates, Congress intended that no change was to be made in the amount of the deficiency determined by the Tax Court after the decision of the court becomes final, "no matter how meritorious a claim for abatement of the assessment or for refund" may be raised thereafter. "Finality is the end sought to be obtained by these provisions ... and to allow the reopening of the question of the tax ... either by the taxpayer or by the Commissioner (save in the sole case of fraud) would be highly undesirable." S. Rep. No. 52, 69th Cong., 1st Sess. 26 (1926), reprinted in 1939-1 (Part 2) C.B. 332, 351. In the opinion resulting from the motion for reconsideration, the Tax Court noted that it was "unlikely" that petitioner could utilize the procedure set out in Rev. Proc. 81-27 because section 6512(a) would probably be construed as barring any claim for refund after a petition has been filed in the Tax Court.² 81 T.C. at 955-56.

Chapter 65 of the Internal Revenue Code describes abatements, credits, and refunds. Sections 6403 and 6404 of this chapter directly address the concerns raised in the request for tax litigation advice about section 6512. Section 6403 states:

In the case of a tax payable in installments, if the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any.... (Emphasis added).

² Section 6512(a) provides that no credit or refund may be claimed and no suit shall be instituted in any court, if a taxpayer files a timely petition with the Tax Court after receiving a notice of deficiency.

Section 6404 states:

(a) General Rule. -- The Secretary is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which-

(1) is excessive in amount

* * *

(b) No Claim for Abatement of Income, Estate, and Gift Taxes. -- No claim for abatement shall be filed by a taxpayer in respect of an assessment of any tax imposed under subtitle A or B.

Thus, it is apparent that use of Rev. Proc. 81-27 by estates making installment payments pursuant to section 6166 amounts to a claim for credit. The Tax Court was, therefore, correct in holding that Rev. Proc. 81-27 is unavailable to an estate once a petition is filed. Estate of Bailly, 81 T.C. at 957-58.

In your request for tax litigation advice, you also analogize the interest expense deduction at issue to the allowance of postdecision legal expenses and point to Form 5-4-4 of the Tax Litigation Form Book. Not all legal expenses which are paid are necessarily deductible on the estate tax return. The estate should make a reasonable estimate of the attorney's fees it will incur during the administration of the estate and deduct them on the initial estate tax return in accordance with Treas. Reg. § 20.2053-1(b)(3). However, because an estate cannot be sure at the time it files its initial estate tax return whether it will be involved in litigation with the Service over the amount of the tax owed, Treas. Reg. § 20.2053-3(c) provides a deduction for attorney's fees incurred in contesting an asserted deficiency or in prosecuting a claim for refund. The amount of the final decision or judgment should reflect this deduction. Similarly, the estate is entitled to a deduction for attorney's fees incurred in any appellate proceedings brought to review the decision of the lower court.

The reason that the analogy to a deduction for attorney's fees incurred in appellate proceedings is inappropriate to the deduction for interest expense at issue herein is because of the principle of finality of judgments. The decision of the Tax Court becomes final unless a notice of appeal is timely filed. Section 7481(a). Once the decision of the Tax Court is final, it cannot be reopened absent a statutory exception, such as section 7481(d) or section 2011(c), or a court-authorized exception, such as fraud. However, with or without the stipulation in Form 5-4-4(1), the estate would be entitled to its deduction for attorney's fees incurred in the appellate proceedings if raised properly prior to finality.

Although various administrative solutions to section 7481(d) have been proposed and considered, we are bound by the strictures of the Code. Thus, we believe the only appropriate manner in which to handle section 2053 interest deductions in the context of section 7481(d) is via a stipulation in the decision document.

Because the amount of the accrued interest to date can be determined in the instant case, the decision portion of the decision document should state the amount of the deficiency as of a date certain. For example, if the last annual installment was paid on December 12, 1989, the entry would read:

ORDERED and DECIDED: That there is a deficiency in estate tax due from the petitioner in the amount of \$_____ as of December 12, 1989.

The stipulation would then read:

It is stipulated that the deficiency in this case is computed without regard to a deduction pursuant to I.R.C. § 2053 with respect to any interest which may be due or paid with respect to the estate tax liability in this case, or payable pursuant to the I.R.C. § 6166 election after December 12, 1989; and that upon taxpayer's motion, this case may be reopened by the Court for the sole purpose of modifying the Court's decision to reflect the deduction for such state or federal interest paid by the taxpayer, pursuant to I.R.C. § 7481(d).

State death tax credit

Section 2011 provides for a credit against the estate tax for the amount of any estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia in respect of any property included in the gross estate. Section 2011(c) discusses the period of limitations on credit. It provides:

The credit allowed by this section shall include only such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that-

- (1) If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed by section 6213(a), then within such 4-year period or before the expiration of 60 days after the

decision of the Tax Court becomes final.

(2) If, under section 6161 or 6166, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

(3) If a claim for refund or credit of an overpayment of tax imposed by this chapter has been filed within the time prescribed by section 6511, then within such 4-year period or before the expiration of 60 days from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of any part of such claim, or before the expiration of 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon such claim, whichever is later.

The request for tax litigation advice argues that the three exceptions in section 2011(c) are mutually exclusive. Therefore, the argument appears to run, if a petition is filed in the Tax Court, the claim for credit for state death taxes must be made by the later of the 4 year period after the return is filed or before the expiration of 60 days after the decision of the Tax Court becomes final.

It is apparent that subsection 2011(c)(1) and subsection 2011(c)(3) are mutually exclusive. Subsection 2011(c)(3) was added because Congress was concerned with correcting what it perceived to be discriminatory treatment. Congress was concerned with affording equal treatment to those taxpayers who initially paid a disputed amount and then filed a claim for refund, *i.e.*, taxpayers who pursued the refund route rather than the Tax Court route with respect to a disputed amount. Empire Trust Co. v. United States, 214 F. Supp. 731 (D. Conn.), aff'd per curiam, 324 F.2d 507 (2d Cir. 1963). However, the legislative history which discusses the enactment of section 813(b)(3), the predecessor of section 2011(c)(3), indicates that section 2011(c)(2) is not preempted by (c)(1) or (c)(3). H.R. Rep. No. 775, 85th Cong., 1st Sess. (1958) states:

These State death taxes generally must be paid within 4 years after the estate tax return is filed in order to be eligible for this credit. However, if an extension of time is granted to pay the federal estate tax, the State death taxes need not be paid until after this period of extension. Similarly, if a petition for redetermination

of a deficiency is filed with the Tax Court within 90 days after notice of a deficiency is mailed, the State death taxes need not be paid until 60 days after the Tax Court's decision becomes final in order to be eligible for credit against the estate tax.

Pursuant to Rev. Rul. 86-38, 1986-1 C.B. 296, a recomputation procedure like the one described in Rev. Proc. 81-27 may be used to recompute the total remaining estate tax liability whenever the estate submits certification of payment of additional estate tax within the section 6166 installment payment period.

Because section 2011(c)(2) extends the period of limitations for credit on state death taxes where an estate is making installment payments pursuant to section 6166, it is the Service's position that deficiencies entered by the Tax Court can be reduced to reflect any section 2011(c) credits available to the estate within the statutory period. This is effected by having a stipulation in the decision document that the deficiency entered by the Tax Court may be decreased upon substantiation of payment of additional state death taxes. We have no objection to a stipulation to allay any concerns about the statutory period within which to claim the additional state death tax credit. Such a stipulation could read:

It is further stipulated that the petitioner may claim a credit for state estate, inheritance, legacy or succession taxes, in an amount up to \$_____, and may present to the Internal Revenue Service proof of such payment within the statutory period established by I.R.C. § 2011(c)(2).

Pursuant to the Clerk's Office of the Tax Court, a notation should appear beneath the docket number on the decision document that the decision is being entered pursuant to I.R.C. § 7481(d).

If you have any additional questions, please contact Helen F. Rogers at FTS 566-3442.

MARLENE GROSS

By: 
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